

## Summary of Sections Affecting Small Businesses

### **Sec. 1001 Reduction and simplification of individual income tax rates**

- The current seven tax brackets would be consolidated and simplified into four brackets: 12%, 25%, 35% and 39.6%, in addition to an effective fifth bracket at 0% in the form of the enhanced standard deduction.
- For married taxpayers filing jointly, the 25% bracket threshold would be \$90,000, the 35% bracket threshold would be \$260,000, and the 39.6% bracket threshold would be \$1 million.
- For unmarried individuals and married individuals filing separately, the bracket thresholds would be half the thresholds for married taxpayers filing jointly, except that the 35% bracket threshold for unmarried individuals would be \$200,000.
- For single parents filing as a head of a household, the bracket thresholds would be the midpoint between the thresholds for unmarried individuals and married taxpayers filing jointly, except that the 39.6% bracket threshold for heads of household would be \$500,000.
- These income levels would be indexed for chained CPI instead of CPI, a slightly different measure of inflation.

### **Sec. 1002 Enhancement of standard deduction**

- The standard deduction would be increased to \$24,000 for joint filers and \$12,000 for individual filers.
- Single filers with at least one qualifying child could claim a standard deduction of \$18,000.
- These amounts would be adjusted for inflation based on chained CPI.

### **Sec. 1003 Enhancement of standard deduction**

- The deduction for personal exemptions and the personal exemption phase-out would be repealed.

### **Sec. 1004 Maximum rate on business income of individuals**

- Reduces rate for pass throughs to 25% for a portion of their net income, which can be treated as “business income” instead of the individual rate.
- The remaining portion of net business income would be treated as compensation and continue to be subject to ordinary individual income tax rates
- Each owner or shareholder would separately determine their proportion of business income
- Net income derived from a passive business activity would be treated as business income and fully eligible for the 25% max rate.
- Owners or shareholders receiving net income derived from an active business activity (including wages) would determine their business income by reference to their “capital percentage” of the net income from such activities

- **Brady Amendment:** The amendment provides a 9-percent tax rate, in lieu of the ordinary 12-percent tax rate, for the first \$75,000 in net business taxable income of an active owner or shareholder earning less than \$150,000 in taxable income through a pass-through business.
  - As taxable income exceeds \$150,000, the benefit of the 9-percent rate relative to the 12-percent rate is reduced, and it is fully phased out at \$225,000.
  - Businesses of all types are eligible for the preferential 9-percent rate, and such rate applies to all business income up to the \$75,000 level.
  - The 9-percent rate is phased in over five taxable years, such that the rate for 2018 and 2019 is 11 percent, the rate for 2020 and 2021 is 10 percent, and the rate for 2022 and thereafter is 9 percent.
  - For unmarried individuals, the \$75,000 and \$150,000 amounts are \$37,500 and \$75,000, and for heads of household, those amounts are \$56,250 and \$112,500.
- Under the provision, owners or shareholders may elect to apply a capital percentage of 30% to the net business income derived from active business activities to determine their business income eligible for the 25% rate.
- That determination would leave the remaining 70% subject to ordinary individual income tax rates.
- Owners or shareholders may elect to apply a formula based on the facts-and-circumstances of their business to determine a capital percentage of greater than 30%.
- That formula would measure the capital percentage based on a rate of return (the Federal short-term rate plus 7%) multiplied by the capital investments of the business.
- Once made, the election of the alternative formula would be binding for a 5 year period.
- A special rule would apply to prevent the recharacterization of actual wages paid as business income
- An owner's or shareholder's capital percentage would be limited if actual wages or income treated as received in exchange for services from the pass-through entity exceeds the taxpayer's otherwise applicable capital percentage.
- The determination of whether a taxpayer is active or passive with respect to a particular business activity would rely on current law material participation and activity rules within regulations governing the limitation on passive activity losses under Code section 469.
- Under these rules, the determination of whether a taxpayer is active generally is based on the number of hours the taxpayer spends each year participating in the activities of the business.
- Income subject to preferential rates, such as net capital gains and qualified dividend income, would be excluded from any determination of a business owner's capital percentage.
- Such income would not be recharacterized as business income for these purposes and would retain its character.
- Certain other investment income that is subject to ordinary rates such as short-term capital gains, dividends, and foreign currency gains and hedges not related to the business needs, would also not be eligible to be recharacterized as business income.

- Interest income properly allocable to a trade or business would be eligible to be recharacterized as business income.
- Under the provision, the default capital percentage for certain personal services businesses (e.g., businesses involving the performance of services in the fields of law, accounting, consulting, engineering, financial services, or performing arts) would be zero percent.
- As a result, a taxpayer that actively participates in such a business generally would not be eligible for the 25 % rate on business income with respect to such personal service business.
- However, the provision would allow the same election to owners of personal services businesses to use an alternative capital percentage based on the business's capital investments.
- This election would be subject to certain limitations.
- The provision would also apply a maximum 25 % rate on certain dividends from a real estate investment trust (REIT) and patronage dividends from cooperatives.
- The provision would be effective for tax years beginning after 2017

#### **Sec. 1005 Conforming amendments related to simplification of individual income tax rates**

- Makes technical and conforming amendments to the Internal Revenue Code related to reduction and simplification of individual income tax rates.

### **Title III – Business Tax Reform**

#### **Sec. 3001 Reduction in corporate tax rate**

- Lowers to 20% of taxable income beginning 2018
- The amendment lowers the 80-percent dividends received deduction to 65 percent and the 70-percent dividends received deduction to 50 percent, preserving the current law effective tax rates on income from such dividends.
- Creates a special rule for personal service corps
  - They will be taxed at 25%

#### **Sec. 3101 Increased Expensing**

- Taxpayers are able to fully and immediately expense 100% of the cost of qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023.
- The provision would expand the property that is eligible for this immediate expensing by repealing the requirement that the original use of the property begin with the taxpayer.
- Instead, the property would be eligible for the additional depreciation if it is the taxpayer's first use.
- Under the provision, qualified property would not include any property used by a regulated public utility company or any property used in a real property trade or business.
- The amendment provides an exclusion from the limitation on deductibility of net business interest for taxpayers that paid or accrued interest on "floor plan financing

indebtedness.” Full expensing would no longer be allowed for any trade or business that has floor plan financing indebtedness.

- The taxpayer’s election to use AMT in lieu of the additional depreciation would be repealed effective after 2017.

### **Section 3201 Expansion of section 179 expensing**

- The small business expensing limitation under section 179 would be increased to \$5 million and the phase-out amount would be increased to \$20 million.
- The provision would modify the expensing limitation by indexing both the \$5 million and \$20 million limits for inflation.
- The provision would modify the definition of section 179 property to include qualified energy efficient heating and air-conditioning property permanently.
- The provision to modify the definition of section 179 property to include qualified energy efficient heating and air-conditioning property would be effective for property acquired and placed in service after November 2, 2017.
- The provision to increase the dollar limitations would be effective for tax years beginning after 2017 through tax years beginning before 2023.

### **3202 Small business accounting method reform and simplification**

#### *Cash Method of Accounting*

- The \$5 million threshold for corporations and partnerships with a corporate partner would be increased to \$25 million and the requirement that such businesses satisfy the requirement for all prior years would be repealed.
- The increased \$25 million threshold would be extended to farm corporations and farm partnerships with a corporate partner, as well as family farm corporations.
- Also under the provision, the average gross receipts test would be indexed to inflation.

#### *Accounting for Inventories*

- Businesses with average gross receipts of \$25 million or less would be permitted to use the cash method of accounting even if the business has inventories.
- Under the cash method of accounting, a business may account for inventory as non-incidental materials and supplies.
- Under the provision, a business with inventories that qualifies for and uses the cash method of accounting would be able to account for its inventories using its method of accounting reflected on its financial statements or its books and records.

#### *Capitalization and Inclusion of Certain Expenses in Inventory Costs*

- Businesses with average gross receipts of \$25 million or less would be fully exempt from the UNICAP rules.
- This exemption would apply to real and personal property acquired or manufactured by such business.

### *Accounting for Long-term Contracts*

- The \$10 million average gross receipts exception to the percentage-of-completion method would be increased to \$25 million.
- Businesses that meet the increased average gross receipts test would be permitted to use the completed-contract method (or any other permissible exempt contract method).

### **Sec. 3203. Small business exception from limitation on deduction of business interest.**

- Businesses with average gross receipts of \$25 million or less would be exempt from the interest limitation rules described in section 3301.

### **Section 3204 – Modify treatment of S corporation conversions into C corporations – Mullin Amendment**

- The amendment provides that distributions from an eligible terminated S corporation would be treated as paid from its accumulated adjustments account and from its earnings and profits on a pro-rata basis.
- The amendment provides that any section 481(a) adjustment would be taken into account ratably over a 6-year period.
- For this purpose, an eligible terminated S corporation means any C corporation which (i) was an S corporation on the date before the enactment date, (ii) revoked its S corporation election during the 2-year period beginning on the enactment date, and (iii) had the same owners on the enactment date and on the revocation date

### **Sec. 3301 Interest**

- Under the provision, every business, regardless of its form, would be subject to a disallowance of a deduction for net interest expense in excess of 30 percent of the business' adjusted taxable income.
- The net interest expense disallowance would be determined at the tax filer level—for example, at the partnership level instead of the partner level.
- Adjusted taxable income is a business's taxable income computed without regard to business interest expense, business interest income, net operating losses, and depreciation, amortization, and depletion.
- Any interest amounts disallowed under the provision would be carried forward to the succeeding five taxable years and would be an attribute of the business (as opposed to its owners).
- **Special rules would apply to allow a pass-through entity's unused interest limitation for the taxable year to be used by the pass-through entity's owners and to ensure that net income from pass-through entities would not be double counted at the partner level.**
- The provision, as amended by the provision under section 3204, would provide an exemption from these rules for businesses with average gross receipts of \$25 million or less.
- Additionally, the provision would not apply to certain regulated public utilities and real property trades or businesses. These businesses would be ineligible for full expensing in section 3101.
- The amendment provides an exclusion from the limitation on deductibility of net business interest for taxpayers that paid or accrued interest on "floor plan financing indebtedness." Full expensing would no longer be allowed for any trade or business that has floor plan financing indebtedness.

**Sec. 3302. Modification of net operating loss deduction**

- Taxpayers would be able to deduct an NOL carryover or carryback only to the extent of 90 percent of the taxpayer's taxable income (determined without regard to the NOL deduction) – conforming to the current-law AMT rule.
- The provision also would generally repeal all carrybacks but provide a special one-year carryback for small businesses and farms in the case of certain casualty and disaster losses.
- The provision generally would be effective for losses arising in tax years beginning after 2017.
- In the case of any net operating loss, specified liability loss, excess interest loss or eligible loss, carrybacks would be permitted in a taxable year beginning in 2017, as long as the NOL is not attributable to the increased expensing that would be allowed under section 3101.
- Additionally, the provision would allow NOLs arising in tax years beginning after 2017 and that are carried forward to be increased by an interest factor to preserve its value.

**Sec. 3303. Like-kind exchanges of real property.**

- The special rule allowing deferral of gain on like-kind exchanges would be modified to allow for like-kind exchanges only with respect to real property.
- The provision would be effective for transfers after 2017.
- However, the provision would provide a transition rule to allow like-kind exchanges of personal property to be completed if the taxpayer has either disposed of the relinquished property or acquired the replacement property on or before December 31, 2017.

**Sec. 3304. Revision of treatment of contributions to capital.**

- The gross income of a corporation would include contributions to its capital, to the extent the amount of money and fair market value of property contributed to the corporation exceeds the fair market value of any stock that is issued in exchange for such money or property.
- Similar rules would apply to contributions to the capital of any noncorporate entity, such as a partnership.
- The provision would be effective for contributions made, and transactions entered into, after the date of enactment.

**Sec. 3305. Repeal of deduction for local lobbying expenses.**

- Deductions for lobbying expenses with respect to legislation before local government bodies (including Indian tribal governments) would be disallowed.
- The provision would be effective for amounts paid or incurred after 2017.

**Sec. 3306. Repeal of deduction for income attributable to domestic production Activities**

- The deduction for domestic production activities would be repealed for tax years beginning after 2017

**Sec. 3307. Entertainment, etc. expenses**

- No deduction would be allowed for entertainment, amusement or recreation activities, facilities, or membership dues relating to such activities or other social purposes.
- In addition, no deduction would be allowed for transportation fringe benefits, benefits in the form of on-premises gyms and other athletic facilities, or for amenities provided to an employee that are primarily personal in nature and that involve property or services not directly related to the employer's trade or business, except to the extent that such benefits are treated as taxable compensation to an employee (or includible in gross income of a recipient who is not an employee).
- The 50-percent limitation under current law also would apply only to expenses for food or beverages and to qualifying business meals under the provision, with no deduction allowed for other entertainment expenses.
- Furthermore, no deduction would be allowed for reimbursed entertainment expenses paid as part of a reimbursement arrangement that involves a tax-indifferent party such as a foreign person or an entity exempt from tax. The provision would be effective for amounts paid or incurred after 2017.

**Sec. 3308. Unrelated business taxable income increased by amount of certain fringe expenses for which deduction is disallowed.**

- Tax-exempt entities would be taxed on the values of providing their employees with transportation fringe benefits, and on-premises gyms and other athletic facilities, by treating the funds used to pay for such benefits as unrelated business taxable income, thus subjecting the values of those employee benefits to a tax equal to the corporate tax rate.
- The provision would be effective for amounts paid or incurred after 2017.

**Sec. 3309. Limitation on deduction for FDIC premiums.**

- A percentage of such assessments would be non-deductible for institutions with total consolidated assets in excess of \$10 billion.
- The percentage of nondeductible assessments would be equal to the ratio that total consolidated assets in excess of \$10 billion bears to \$40 billion, so that assessments would be completely non-deductible for institutions with total consolidated assets in excess of \$50 billion.
- The provision would be effective for tax years beginning after 2017.

**Sec. 3310. Repeal of rollover of publicly traded securities gain into specialized small business investment companies.**

- Under the provision, the special rule permitting gains on publicly traded securities to be rolled over to an SSBIC would be repealed.
- The provision would be effective for sales after 2017.

**Sec. 3311. Certain self-created property not treated as a capital asset.**

- Gain or loss from the disposition of a self-created patent, invention, model or design (whether or not patented), or secret formula or process would be ordinary in character.
- This would be consistent with the treatment of copyrights under current law.
- In addition, the election to treat musical compositions and copyrights in musical works as a capital asset would be repealed.
- The provision would be effective for dispositions of such property after 2017.

**Sec. 3312. Repeal of special rule for sale or exchange of patents.**

- Under the provision, the special rule treating the transfer of a patent prior to its commercial exploitation as long-term capital gain would be repealed.
- The provision would be effective for dispositions after 2017.

**Sec. 3313. Repeal of technical termination of partnerships.**

- The technical termination rule would be repealed.
- Thus, the partnership would be treated as continuing even if more than 50 percent of the total capital and profits interests of the partnership are sold or exchanged, and new elections would not be required or permitted.
- The provision would be effective for tax years beginning after 2017.

**Section 3315 – Amortization of Research and Experimentation Expenditures**

- The amendment provides that certain research or experimental expenditures are required to be capitalized and amortized over a 5-year period (15 years in the case of expenditures attributable to research conducted outside the United States).
- The amendment provides that this rule applies to research or experimental expenditures paid or incurred during taxable years beginning after 2023.

**Section 3316 – Uniform treatment of expenses in contingent fee cases**

- The amendment disallows an immediate deduction for litigation costs advanced by an attorney to a client in contingent-fee litigation until the contingency is resolved, thus creating parity throughout the United States as to when, if ever, such expenses are deductible in such litigation.
- Under current law, certain attorneys within the Ninth Circuit who work on a contingency basis can immediately deduct expenses that ordinarily would be considered fees paid on behalf of clients, in the form of loans to those clients, and therefore not deductible when paid or incurred.



- This provision creates parity on this issue throughout the United States by essentially repealing the Ninth Circuit case, *Boccardo v. Commissioner*, 56 F.3d 1016 (9th Cir. 1995), which created a circuit split on this issue.